



## STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	03/22/06	Bill No:	AB 2001
Tax:	Cigarette and Tobacco Products	Author:	Cogdill
Related Bills:			

### BILL SUMMARY

This bill would delete the January 1, 2007, repeal date to indefinitely extend the following provisions:

- A distributor's election to make payment on a twice-monthly basis for amounts owing for stamps and meter register settings purchased on a deferred basis;
- Reduced security for distributors that elect to make deferred payment on a twice-monthly basis;
- A distributor's election to either file a return and remit payment of the amount of tax due respecting his or her distributions of tobacco products and the wholesale cost during the preceding month on a monthly or twice-monthly basis.

### Summary of Amendments

The amendments to this bill since the previous analysis delete the provisions that would have allowed a distributor that desires to purchase cigarette tax stamps on a deferred payment basis to post a security deposit in the form of negotiable assets or as a pledge of a secured interest in real property.

### ANALYSIS

#### Current Law

Under current Cigarette and Tobacco Products Tax Law, an excise tax of 43 1/2 mills per cigarette (87 cents per package of 20) is imposed on each cigarette distributed. The cigarette tax imposed with respect to the distribution of cigarettes is paid by distributors through the use of stamps or meter impressions. An appropriate stamp or meter impression is required to be affixed to, or made on, each package of cigarettes prior to distribution of the cigarettes, except as otherwise provided.

Current law also imposes a surcharge on tobacco products at a rate to be annually determined by the Board. The tobacco products tax rate is equivalent to the combined rate of tax on cigarettes. Currently, the surcharge rate for fiscal year 2005-06 is 46.76 percent.

#### CIGARETTE TAX STAMPS PURCHASED ON A DEFERRED-PAYMENT BASIS

Every applicant for a license as a distributor is required to file with the Board security in the amount and form as the Board prescribes. The minimum security that is required of

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any distributor is one thousand dollars (\$1,000). However, distributors desiring to defer payment for stamps and meter impressions are required to furnish a security in an amount as follows:

- Equal to not less than 70 percent of the amount and not more than twice the amount, as fixed by the Board, of the distributor's purchases of stamps and meter register settings for which payment may be deferred if a distributor elects to make payments on a monthly basis.
- Equal to not less than 50 percent of the amount and no more than twice the amount, as fixed by the Board, of the distributor's purchases of stamps and meter register settings for which payment may be deferred if a distributor elects to make payments on a twice-monthly basis.

A distributor may elect a monthly or twice-monthly payment basis for amounts owing for stamps and meter register settings purchased on a deferred basis. If a distributor elects a monthly basis, payment is required to be remitted on or before the 25<sup>th</sup> day of the month following the month in which the stamps and meter register settings were purchased. However, if a distributor elects a twice-monthly payment basis, the payment is due based on the following schedule:

- The first monthly remittance would be due on or before the 5<sup>th</sup> day of the month. The amount due would be equal to either one-half of the total amount of those purchases of stamps and meter register settings made during the preceding month or the total amount of those purchases stamps and meter register settings made between the first day and the 15<sup>th</sup> day of the preceding month, *whichever is greater*.
- The second monthly remittance would be made on or before the 25<sup>th</sup> day of the month for the remainder of those purchases of stamps and meter register settings that were made in the preceding month.

A distributor that elects to make deferred payments on a twice-monthly basis is also required to file a report on or before the 5<sup>th</sup> day of the month respecting his or her distributions of cigarettes and purchases of stamps and meter register settings.

The twice-monthly deferred payment option for amounts owing for stamps and meter register settings purchased on a deferred basis and corresponding reduced security will remain in effect until January 1, 2007, and as of that date is repealed.

#### **TWICE-MONTHLY ELECTION TO FILE A RETURN AND MAKE PAYMENT FOR TOBACCO PRODUCTS TAX**

A distributor is authorized to elect to file a return and make payment of the tax due on either a monthly or a twice-monthly basis respecting his or her distributions of tobacco products and their wholesale cost during the preceding month and any other information as the Board may require. If a distributor elects a monthly basis, the distributor is required to file a return and make payment of the tax on or before the 25<sup>th</sup> day of the month following the month during which the tobacco products were distributed. If a distributor elects a twice-monthly basis, the distributor is required to file two returns and make two remittances during the month following the month during which the tobacco products were distributed as follows:

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- The first monthly return would be required to be filed, together with the first remittance of tax, on or before the 5<sup>th</sup> day of the month for those distributions of tobacco products that occurred between the first day and the 15<sup>th</sup> day of the preceding month.
- The second monthly return would be required to be filed, together with the second remittance of tax, on or before the 25<sup>th</sup> day of the month for those distributions of tobacco products that occurred between the 16<sup>th</sup> day and last day of the preceding month.

The twice-monthly payment and reporting basis for distributions of tobacco products will remain in effect until January 1, 2007, and as of that date is repealed.

### **Proposed Law**

This bill would amend and repeal Sections 30142, 30168, and 30182 of the Revenue and Taxation Code to delete the January 1, 2007, repeal date to indefinitely extend the twice-monthly deferred payment option for amounts owing for stamps and meter register settings purchased on a deferred basis and corresponding reduced security amount, and twice-monthly payment and reporting basis for distributions of tobacco products.

This bill would become effective January 1, 2007.

### **Background**

In 2003, the Legislature approved and the Governor signed AB 1666 (Ch. 867, Cogdill) which authorizes a cigarette distributor to elect a twice-monthly deferred payment option for amounts owing for stamps and meter register settings purchased on a deferred basis, reduces the corresponding reduced security amount, and authorizes a tobacco products distributor to elect a twice-monthly payment and reporting basis for distributions of tobacco products.

AB 1666 also required, on or before January 1, 2006, the Legislative Analyst, with assistance of, and based on information provided by, the Board, to prepare a report to the Legislature of the economic impact of the bill. The report was required to include an evaluation of the Board's ability to collect cigarette tax revenues, additional revenues, if any, generated by the twice-monthly payment program, and the ability of distributors to access security bonds.

The Legislative Analyst's Office<sup>1</sup> report contained the following recommendation:

"In general, the ability of cigarette distributors to defer payment for cigarette tax stamps until sometime after the tax has been collected is appropriate policy. Chapter 867 represented an attempt to improve the ability of distributors to defer payment while not worsening the state's risk in making such delayed payment possible. The program was undertaken at a time when substantially higher cigarette taxes were being discussed. That the program enrolled few participants may in part be due to the fact that the higher taxes were not, in fact, imposed. If new taxes were to be adopted in the future, however, additional program

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<sup>1</sup> [http://www.lao.ca.gov/2006/cigarette\\_bonds/cigarette\\_bonds\\_012506.pdf](http://www.lao.ca.gov/2006/cigarette_bonds/cigarette_bonds_012506.pdf)

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participation could occur. This is because the higher tax amounts would necessitate greater security amounts under the credit option.

“To date, Chapter 867 has had a minor fiscal impact on the state. It appears that minor administrative costs have been more than offset by additional interest earnings. Furthermore, the added exposure to the state from the lower security amount has only marginally increased financial risk to the state. Therefore, we recommend that the program be continued. It may assist the distributor market to continue to be a competitive industry, and may make it more feasible for small and moderate-size wholesalers to continue to compete by expanding their ability to defer payment for cigarette tax stamps.”

### **In General**

Every applicant for a license as a distributor is required to file with the Board a security in the amount and form as the Board prescribes. The minimum security that is required of any distributor is one thousand dollars (\$1,000). However, every distributor desiring to purchase tax stamps or meter register settings on the deferred payment basis would request the Board to set the maximum amount of such purchases the distributor may have unpaid at any time and the amount of the required bond. The maximum amount of stamps and meter register setting purchases for which the distributor may defer payment cannot exceed one and one-half times the distributor's average monthly tax liability based on the distributor's previous six months' experience. Or in the case of a distributor not previously authorized to make deferred payment purchases or a distributor the character of whose business has changed substantially, the maximum amount will be set at one and one-half times the estimated average monthly tax liability as determined by the Board. When a distributor is authorized to purchase stamps or meter register settings on the deferred payment basis, the bond will be fixed in an amount equal to 50 or 70 percent, depending on a distributor's deferred payment basis election, of the amount of deferred payment purchases which the distributor may have unpaid at any time.

The privilege of making deferred payment purchases will be suspended if there is a delinquent balance owing.

### **COMMENTS**

1. **Sponsor and purpose.** This bill is sponsored by the California Distributors Association and is intended to respond to the Legislative Analyst's Office recommendation that the program implemented by AB 1666 be continued.
2. **Key amendments.** The **March 22, 2006, amendments** delete the provisions that would have allowed a distributor to post alternative forms of security, as added in the March 13, 2006 version of the bill.

The **March 13, 2006, amendments** would have allowed a distributor that desires to purchase cigarette tax stamps on a deferred payment basis to post a security deposit in the form of negotiable assets or as a pledge of a secured interest in real property.

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3. **Distributors purchasing tax stamps on a deferred basis.** Currently, 24 of the 126 distributors licensed with the Board purchase cigarette tax stamps on a deferred basis. In terms of value of the stamps, over 70 percent of all stamp revenue is derived from stamps that have been purchased through deferred payments.

The combined credit limit for distributors purchasing cigarette tax stamps on a deferred basis is approximately \$155 million, with a corresponding security of \$107 million. The credit limit and corresponding security for distributors electing the monthly or twice-monthly payment basis is as follows:

- Distributors electing the **monthly payment basis** have an approximate total credit limit of \$146 million, with a corresponding security of \$102 million.
- Distributors electing the **twice-monthly payment basis** have an approximate total credit limit of \$9 million, with a corresponding security of \$4.5 million.

The Board is authorized to suspend a distributor's privilege to purchase tax stamps on the deferred basis if a distributor fails to promptly pay for stamps when payment is due. If collection of these amounts remains unpaid, the Board could pursue the distributor's security deposit.

4. **What effect has AB 1666 had on the Board?** Since the inception of the twice-monthly payment election for cigarette tax stamps purchased on a deferred-payment basis and corresponding reduced security, two distributors have elected to take advantage of the program.

Implementation of the twice-monthly payment option and corresponding reduced security has had no impact on the Board's ability to collect cigarette tax revenues. However, it should be noted that the Board has not had a collection problem with respect to cigarette tax stamps purchased on a deferred payment basis in the last ten years other than one instance in 2003 involving a bankruptcy case. That case involved a late payment of tax, which was subsequently recovered with interest from the distributor's surety bond.

AB 1666 also authorized a distributor of tobacco products to elect to file a return and make payment of the tax due on either a monthly or a twice-monthly basis respecting his or her distributions of tobacco products and the wholesale cost during the preceding month. However, no tobacco products distributor has elected to file returns or make payments of the tobacco products tax on a twice-monthly basis.

5. **Extending the provisions added by AB 1666 would not be problematic for the Board.** Since the Board already administers the deferred payment options, deleting the repeal date would not be problematic for the Board.

## **COST ESTIMATE**

At present, it is estimated that this bill would not impact the Board's administrative costs. However, the Board would incur non-absorbable administrative costs (mainly in the area of computer programming) if more distributors elect to participate in the twice-monthly payment program as this increased participation would necessitate automation of the Board's return processing in this area. In such case, the Board would request the necessary resources to address this new workload, as required by this bill.

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There would also be an additional cost related to the Board's contract with Bank of America (BoFA) to accept and process twice-monthly payments. The current contract, which will expire on June 30, 2008, is based on the amount of activity for the services provided. As such, any additional distributors desiring to make payments twice-monthly for amounts owing for stamps and meter register settings would increase activity with BoFA and the related cost for services. However, the current contract contains a maximum agreement amount of \$114,696 for the July 1, 2005 through June 30, 2008 contract period.

## REVENUE ESTIMATE

The interest income related to a distributor election to make payment on a twice-monthly basis for deferred purchases of stamps and meter register settings is estimated to amount to approximately \$70,000 annually.

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